

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments
Activity Status Report

ITEM NUMBER: 9

ATTACHMENT(S): 7

ACTION: _____

DATE OF MEETING: July 12, 2000

INFORMATION: X

PRESENTER(S): Réal Desrochers

The table below contains Alternative Investment activity for the month of May 2000 and historical information for selected time periods.

	Month Ended 5/31/00	Fiscal Year To Date	Past One Year	Past Three Years	Past Five Years
<u>Commitments:</u>					
Partnerships	\$ 300,000,000	\$ 1,738,850,000	\$ 1,738,850,000	\$ 4,259,246,613	\$ 5,431,556,849
Co-Investments	20,000,000	92,499,996	92,499,996	92,499,996	139,499,996
Secondaries	0	70,773,417	70,773,417	80,067,245	80,067,245
	\$ 320,000,000	\$ 1,902,123,413	\$ 1,902,123,413	\$ 4,431,813,854	\$ 5,651,124,090
<u>Contributions:</u>					
Partnerships	\$ 99,829,037	\$ 1,281,251,802	\$ 1,331,735,085	\$ 2,598,964,649	\$ 3,216,623,577
Co-Investments	496,682	43,663,367	43,663,367	43,663,367	90,663,367
Secondaries	856,000	62,927,755	62,927,755	70,689,584	70,914,584
Mgmt. Fee (Outside)	195,144	9,338,865	9,338,865	26,263,105	36,365,761
	\$ 101,376,863	\$ 1,397,181,790	\$ 1,447,665,072	\$ 2,739,580,706	\$ 3,414,567,290
<u>Distributions:</u>					
Cash	\$ 37,255,787	\$ 413,419,882	\$ 433,115,827	\$ 1,149,669,590	\$ 1,548,902,844
Stock	32,862,091	794,463,530	813,072,406	1,096,890,810	1,284,204,151
	\$ 70,117,878	\$ 1,207,883,412	\$ 1,246,188,232	\$ 2,246,560,401	\$ 2,833,106,995
Stock Sales	\$ 26,997,941	\$ 639,224,078	\$ 663,736,286	\$ 919,106,678	\$ 1,067,202,220

During the month of May 2000, staff made a \$150 commitment to Spectrum Equity Investors IV, and a \$150 million commitment to VantagePoint IV. Both commitments were made in accordance with delegation of authority guidelines. An executive summary of the Spectrum investment is provided in Attachment 1. The executive summary of the VantagePoint investment was presented to the Investment Committee in the Alternative Investment April 2000 Activity Status Report.

Attachments 2 through 6 provide executive summaries of action taken under delegation of authority during the month of June 2000. Staff recommended the following commitments: \$100 million to Apex Excelsior VI, \$400 million to Welsh, Carson, Anderson & Stowe IX, \$30 million to Cortec Group Fund III, \$15

million to InnoCal II, and \$200 million to Navis Partners V. CalSTRS' commitments are subject to successful negotiation of partnership terms and legal review.

Attachment 7 provides an executive summary of action taken under delegation of authority for a \$20 million co-investment in Carolina Broadband Corp.

Delegation #37

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
SPECTRUM EQUITY INVESTORS IV

Action: Commit \$150 million to Spectrum Equity Investors IV which represents 8.6% of the total capitalization of the fund.

Background: Spectrum Equity Investors IV, L.P. (Spectrum IV) is being formed by Brion Applegate and William P. Collatos et al. to make significant investments in a broad cross section of communications, information, and internet product and service companies. In 1994, Messrs. Applegate and Collatos formed Spectrum Equity Investors, L.P. This was followed by the formation of Spectrum Equity Investors II, L.P. in 1997 and Spectrum Equity Investors III, L.P. in 1999.

CalSTRS is an investor in one previous Spectrum fund. CalSTRS committed \$65 million to Spectrum Equity Investors III which was raised in 1999.

Analysis: Spectrum Equity Investors IV qualifies as a follow-on fund as identified in the Alternative Investments policies.

The investment strategy for Spectrum IV is similar to the strategy used in the previous Spectrum funds. This strategy has evolved since the founding of the firm to one based upon an exclusive focus on communications, information and internet product and service companies. This focus contributes to an unusually deep understanding of the technological, regulatory, and economic factors that drive these businesses. The firm focuses its efforts and resources primarily on making investments in companies addressing rapidly growing markets. Many of these companies are service providers whose financial performance is characterized by consistent recurring revenue streams and healthy cash flow margins serving markets with significant barriers to entry. Spectrum IV will acquire significant equity positions in communications and communications-related companies at various stages in their development life-cycle and then work actively with these companies to maximize their potential value.

Investment Thesis: Staff is recommending an investment in Spectrum Equity Investors IV, L.P. for the following reasons:

- Staff has identified Spectrum Equity Investors as a Tier 1 Manager.
- The Spectrum funds have consistently generated upper quartile investment returns.
- Spectrum's equity expansion investment discipline is consistent with the range approved by the Investment Committee to invest 5% to 15% of the Alternative Investment portfolio in equity expansion limited partnerships.
- Co-investment opportunities will be offered with no fees and no carried interest.
- The General Partners are very experienced venture capitalists.
- Staff has received a positive investment recommendation from Pathway Capital Management

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investments advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$150 million to Spectrum Equity Investors IV. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Seth C. Hall
Investment Officer

Date _____

Recommended:

Réal Desrochers
Director of Alternative Investments

Date _____

Approved:

Patrick Mitchell
Chief Investment Officer

Date _____

Delegation #40

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
Apax Excelsior VI, L.P.

- Action: Commit \$100 million to Apax Excelsior VI, L.P. This investment represents 9.1% of the total capitalization of the fund.
- Background: Apax Excelsior VI, L.P. (Excelsior VI) is being formed by Patricof & Co. Ventures (Patricof) to make significant equity investments in a portfolio of e-commerce, consumer/retail, healthcare/biotechnology and information technology/telecommunications companies. Patricof was founded by Alan Patricof in 1969. To date, the firm has raised 8 domestic venture funds and invested over \$1.2 billion in more than 250 companies, including such well-known companies as America Online, Apple Computer, Chevys and Office Depot.
- Analysis: The investment strategy for Excelsior VI is similar to the one used in previous Patricof funds. This strategy is to be an active investor and the firm is usually the lead or sole investor in its portfolio companies. As a partner with its portfolio companies, the firm collaborates on strategic, operating, and recruiting issues and provides a network of pertinent financial and industry contacts for these companies. Investments are focused on high-growth businesses in the four industry groups outlined above. In addition to these four industry groups, the firm also has a later-stage transaction group that pursues larger investments within the e-commerce/services and consumer/retail industry groups. These investments are in mature businesses with established franchises that have the potential to be transformed by the internet or other technological advances. The firm's plan with these later-stage investments is to partner with existing management to build the businesses both through internal growth and acquisitions. In each of its funds, Patricof seeks to build a balanced portfolio that is diversified by industry and stage of development in order to minimize the high degree of volatility that frequently characterizes venture capital investing.

Investment Thesis: Staff is recommending an investment in Apax Excelsior VI, L.P. for the following reasons:

- The Patricof funds have generated good returns. Since 1989, one fund outperformed the Venture Economics Upper Quartile Benchmark and three others had solid second quartile returns that were well above the median for their respective vintage years.
- Patricof's venture capital investment discipline is consistent with the range approved by the Investment Committee to invest 10% to 20% of the Alternative Investment portfolio in venture capital limited partnerships.
- Co-investment opportunities will be offered with no fees and no carried interest.
- The General Partners are very experienced venture capitalists.
- Staff has received a positive investment recommendation from Pathway Capital Management

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investments advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$100 million to Apax Excelsior VI. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Seth C. Hall
Investment Officer

Date _____

Recommended by:

Réal Desrochers
Director of Alternative Investments

Date _____

Approved:

Patrick Mitchell
Chief Investment Officer

Date _____

Delegation #41

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
WCAS IX, L.P.

Action: Commit \$400 million to WCAS IX L.P.. This represents 10% of the total capitalization of the fund.

Background: Welsh, Carson, Anderson & Stowe IX, L.P. is currently raising a \$4 Billion limited partnership fund. WCAS is one of the oldest, largest and most successful firms in the United States providing equity capital. The firm was formed in 1979 by Bruce Anderson, Russell Carson, Patrick Welsh, and Richard Stowe. Over the past twenty-one years, the firm has sponsored eight equity and three subordinated debt limited partnership, which have aggregate capital of \$7.6 billion. Although the early WCAS partnerships primarily invested in venture capital transactions, over time the proportion of buyouts and investments in established companies increased. Virtually no venture capital activity has occurred since the formation of WCAS V in 1989. All buyouts have been friendly, the firm's policy does not allow involvement in a hostile acquisition effort.

CalSTRS is currently an investor in the following funds:

<u>Equity</u>		<u>Debt</u>	
WCAS V	\$30 mil	WCAS CP II	\$30 mil
WCAS VI	\$50 mil	WCAS CP III	\$100 mil
WCAS VII	\$150 mil		
WCAS VIII	<u>\$300 mil</u>		
	\$530 mil		<u>\$130 mil</u>

Analysis: WCAS IX qualified as a follow-on fund as identified in the Alternative Investment policies.

WCAS IX is a leading private equity provider to the information services, telecommunications and healthcare industries. Based on the long established track record, specialized staff, and large fund size, the Firm is considered a significant “player” in each of these sectors. Consequently, WCAS is part of the active deal network for these sectors. WCAS maintains a vast array of senior operating executives and contacts in these industries, which are invaluable in deal sourcing, due diligence, and management recruiting. The Principals utilize their industry expertise and strategic focus to practice “value-added” investing, thereby reducing risk and increasing returns beyond what could have been achieved with financial restructuring alone. The companies invested in are located principally in the United States.

- Investment Thesis:
- 1) WCAS IX is consistent with the approved target to invest 60% of the Alternative Investment Portfolio in buyout partnerships.
 - 2) The WCAS equity funds have, on average, exceeded the Venture Economics Upper quartile Benchmark. V and VIII are significantly above the upper quartile, VII is well above the median, and VI is at the median performance mark.
 - 3) The principles are very experienced within their respective industry specializations.
 - 4) The WCAS investment strategy provides a good fit in the CalSTRS portfolio. There are very few portfolio company holdings in common with CalSTRS’ current partnerships.
 - 5) The General Partners have offered co-investment opportunities to CalSTRS with no fees and no carried interest.
 - 6) Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment Advisor and the CalSTRS Staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$400 million to WCAS IX. CalSTRS' commitment is subject to the successful negotiation of partnership business and legal terms.

By:

Richard Rose
Principal Investment Officer

Date:

Recommended by:

Real Desrochers
Director of Alternative Investments

Date

Approved by:

Patrick Mitchell
Chief Investment Officer

Date

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
CORTEC GROUP FUND III, L.P.

Action:	Commit \$30 million to Cortec Group Fund III, L.P., which represents 10% of the total capitalization of the fund.
Background:	<p>The principals of Cortec have worked with each other for many years. Cortec was founded in 1984 by R. Scott Schafler, Gerald Rosenberg, and Neal A. Kayes. The Cortec founders were previously senior officers of Condec, a publicly-owned, diversified industrial and aerospace products manufacturing company with \$300 million of annual sales and leadership positions in such industry segments as electronic and mechanical controls and instrumentation for industrial and aerospace applications. In 1984, Condec was acquired by a private investor. Condec's senior officers sold their interests and subsequently founded Cortec.</p> <p>Between 1984 and 1989, Cortec invested the capital of its principals. In 1990, Cortec raised \$27.3 million for Cortec Group Fund I, and in 1995 raised \$125 million for Cortec Group Fund II. Since its inception, Cortec has achieved an aggregate gross annual IRR of 49.5% on its realized investments, returning 7.6 times its original investment. Cortec has not experienced a loss or write-off on any of its buyouts.</p>
Analysis:	<p>Cortec Group Fund III qualifies as a new fund as identified in the Alternative Investments' policies.</p> <p>Fund III will have the same objectives and employ the same investment and operating strategy successfully followed by Cortec since 1984. The Partnership will invest primarily in industrial and consumer products manufacturing and distribution companies with transaction values of \$30 to \$250 million. The Partnership will focus on profitable companies that are market leaders, possess proprietary technologies or products, and have identifiable growth opportunities. As it has done over the past 15 years, Cortec will continue to be actively involved in the business development and management of its portfolio companies with the objective of increasing value and realizing a return within approximately five years.</p>
Investment Thesis:	<p>Staff is recommending an investment in Cortec Group Fund III, L.P. for the following reasons:</p> <ul style="list-style-type: none">♦ The Cortec III fund is consistent with approved targets and ranges to invest 50% to 70% of the Alternative Investment portfolio in buy-out limited partnerships.

- ◆ Two of the General Partners three previous funds have generated investment returns in excess of the Venture Economics Upper Quartile Benchmark.
- ◆ The management team are very experienced buy-out specialists.
- ◆ Cortec offers co-investment opportunities with no fees and no carried interest.
- ◆ The Cortec investment strategy provides a good fit in the CalSTRS' portfolio.
- ◆ Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner as previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$30 million to Cortec Group Fund III, L.P. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Trish Taniguchi
Investment Officer

Date_____

Recommended By:

Réal Desrochers
Director of Alternative Investments

Date_____

Approved:

Patrick Mitchell
Chief Investment Officer

Date_____

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
INNOCAL II, L.P.

Action: Commit \$15 million to InnoCal II, L.P., which represents 15% of the total capitalization of the fund.

Background: InnoCal is a private venture capital firm with \$75 million currently under management in InnoCal I. InnoCal is the successor to the InnoVen Group of funds, which began operations in 1972 and was co-founded and managed by Gerald A. Lodge. Harry Lambert was a General Partner with InnoVen, starting in 1984, and Jay Houlihan worked with InnoVen in joint investments beginning in 1988.

InnoCal I was funded exclusively by CalSTRS and was targeted at venture capital investments in high technology with emphasis on information technology and healthcare. InnoCal I's investments are concentrated in California with nearly 75% of companies located in the southern half of the state within a 90-minute drive from InnoCal's headquarters. This geographic concentration enables the Directors to be more closely involved with portfolio companies.

Analysis: InnoCal II qualifies as a follow-on fund as identified in the Alternative Investments' policies.

The Partnership will follow a consistent strategy of investing in early- and later-stage companies in information technology and selected areas of healthcare that have strong management and address large, high growth markets. Proprietary technology and/or other significant barriers to entry are also of prime importance. A focused business strategy, which will enable a company to sustain a meaningful competitive advantage over time, is equally important.

InnoCal generally invests as the lead or co-lead investor with compatible co-investors. InnoCal believes investment management and monitoring is critical to the success of emerging companies and, therefore, to the Partnership. The General Partners are integrally involved with the development of portfolio companies through active participation on boards of directors and committees of the board, as well as corporate partnering activities.

Investment Thesis: Staff is recommending an investment in InnoCal II, L.P. for the following reasons:

- ◆ The InnoCal Fund is consistent with approved targets and ranges to invest 10% to 20% of the Alternative Investment portfolio in venture capital partnerships.
- ◆ The General Partners' previous Fund has generated excellent investment performance that exceeds the Venture Economics upper quartile benchmark.
- ◆ The management team are very experienced venture capitalists.
- ◆ The InnoCal investment strategy provides a good fit in the CalSTRS' portfolio.
- ◆ Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner as previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$15 million to InnoCal II, L.P. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Trish Taniguchi
Investment Officer

Date_____

Recommended By:

Réal Desrochers
Director of Alternative Investments

Date_____

Approved:

Patrick Mitchell
Chief Investment Officer

Date_____

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
NAVIS PARTNERS V., L.P.

Action:	Commit \$200 million to Navis Partners V, L.P. (NP V), which represents 20% of the total capitalization of the fund.
Background:	<p>Habib Gorgi and Robert Van Degna began working together at Fleet Equity Partners (FEP) in January 1986. The business has expanded and currently includes five managing directors, three principals, one vice president, three associates, a chief financial officer and a complete administrative staff. FleetBoston Financial Group was the sole source of capital until the formation of the Chisholm Partners (CP) funds in the early 1990s; however, Fleet's percentage of committed capital has been reduced with the formation of each of the CP funds.</p> <p>CalSTRS committed \$29.5 million to CPIV in July 1999. Since this fund is almost fully committed, the Principals are currently raising Navis Partners V as the successor to FEP and the CP funds. NP V is targeting \$1 billion with a cap of \$1.25 billion in commitments. With the formation of NP V, Fleet has agreed to limit its commitment to 24.9%, up to \$300 million, of the limited partnership interests of NP V. Fleet's investment will be on the same terms as that of the other limited partners. As part of the agreement with Fleet, the General Partners will cease to be employees of Fleet but will continue to manage the FEP portfolio. Navis Partners will retain the investment staff, support staff, and the physical assets of the business.</p>
Analysis:	<p>Navis Partners V qualifies as a follow-on fund as identified in the Alternative Investments' policies.</p> <p>The Navis principals have a long history of focusing on certain segments of the economy that provide opportunities to achieve superior investment returns. Navis intends to focus on five industry sectors: business services, healthcare services, manufacturing, media and information and telecommunication services. The Principals will employ the same proven successful strategies to each industry focus that they have maintained historically.</p> <p>The Partnership will target transactions in the \$25 to \$75 million range. Navis V will maintain the historical practice of focusing on investments where the Principals can actively participate in the strategic and financial direction of the business at the board of directors level. The Principals also prefer to be the lead investor in structuring transactions.</p>
Investment Thesis:	Staff is recommending an investment in Navis Partners V, L.P. for the following reasons:

- ◆ The Navis V Fund is consistent with approved targets and ranges to invest 10% to 20% of the Alternative Investment portfolio in venture capital partnerships.
- ◆ The General Partners previous Funds have consistently generated excellent investment performance.
- ◆ The management team are very experienced venture capitalists.
- ◆ Navis offers co-investment opportunities with no fees and no carried interest.
- ◆ The Navis investment strategy provides a good fit in the CalSTRS' portfolio.
- ◆ Staff has received a positive investment recommendation from Pathway Capital Management.

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. A positive written recommendation by the Alternative Investment's advisor and CalSTRS' staff has been documented. This resulted after an investment analysis and due diligence was conducted in the manner as previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit \$200 million to Navis Partners V, L.P. CalSTRS' commitment is subject to the successful negotiation of partnership terms and legal review.

By:

Trish Taniguchi
Investment Officer

Date_____

Recommended By:

Réal Desrochers
Director of Alternative Investments

Date_____

Approved:

Patrick Mitchell
Chief Investment Officer

Date_____

Alternative Investments

EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
M/C PartnersCarolina Broadband Corporation

Action: Commitment of \$20 million in a co-investment in Carolina Broadband Corp subject to the successful negotiation of legal terms and conditions. The investment will take the form of \$20 million in preferred securities and common equities.

Background: A group of General Partners have come together to raise an investment fund of \$400 million for the purpose of starting up a company to provide broadband telephony, video, and data services to homes and businesses in select communities. Investors include:

Investors:

M/C Ventures
Morgan Stanley
Chase
J.H. Whitney
Harborvest
Providence
Bank of America
Spectrum
CalSTRS
First Union
Chisolm (Fleet)
Carousel

The CalSTRS co-investment of \$20 million will be 5% of the total investment. CalSTRS will be indirectly invested in this transaction through J.H. Whitney, M/C Ventures, Fleet and Spectrum. The investors for CalSTRS are all Tier 1 partnerships.

Plans are to have Carolina Broadband become one of two broadband providers of video, telephony, and data in each of four selected markets.

INVESTMENT THESIS

The Carolina Broadband investment is an investment in the telecom business on “the last mile”. This is the infrastructure, (hybrid fiber coax or HFC) that takes telephony, data services and video into the home and business on a bundled basis on one line. As soon as Carolina Broadband can construct its system, they will be the first players in this space in the selected markets. The sponsors of Carolina Broadband expect the value to these assets to increase dramatically following completion of the project. Staff expects that this investment will attract a large number of takeout buyers.

Policy Compliance: This investment complies with the Alternative Investment Policies, which were approved in April 1999. Positive written recommendations by the Independent Fiduciary (KPMG) and Staff have been documented. The recommendations resulted after investment analysis and due diligence were conducted in a manner as previously reviewed and approved by the Investment Committee.

Recommendation: Staff recommends that CalSTRS commit up to \$20 million to Carolina Broadband. CalSTRS’ commitment is subject to the successful negotiation of legal terms and conditions.

By:

Richard Rose
Principal Investment Officer

Date:_____

Recommended by:

Real Desrochers
Director-Alternative Investments

Date:_____

Approved by:

Patrick Mitchell
Chief Investment Officer

Date:_____